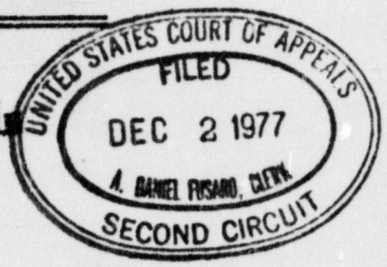
United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL

75-6080



United States Court of Appeals

For the Second Circuit

Docket No. 75-6080

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

against

BERNARD JAY COVEN,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANT-APPELLANT

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

-against-

BERNARD JAY COVEN,

Defendant-Appellant.

Docket No.
Civil 75/6080

On Appeal from the United States
District Court for the Southern
District of New York.

BRIEF FOR DEFENDANT APPELLANT

PRELIMINARY STATEMENT

This is an appeal from a final judgment of permanent injunction rendered against the appellant on August 19, 1975 enjoining the appellant from further violation of Rules 10(b), 5, 6 and 9 of the Securities Exchange Act of 1934 ("Exchange Act"). An application for reconsideration pursuant to Rule 52(b) of the Federal Rules of Civil Procedure was denied in an opinion dated August 19, 1975 (100a).

STATEMENT OF THE ISSUES

Is there reversible error in the lower Court's determination that the defendant aided and abetted the

Underwriter and its principal in violations of Rule 10(b)5, 10(b)6 and 10(b)9, particularly with reference to the Underwriter's failure to use "best efforts"; the Underwriter's trading while distributing, the activities of M. S. Wien in trading the issue; and in matters concerning the escrow fund of the issue? Did the lower Court err in finding it appropriate under the circumstances of the action and evidence at the trial to permanently enjoin the defendant and to permanently enjoin the defendant with respect to any security?

STATEMENT OF THE CASE

This is an action for injunctive relief in which the Securities and Exchange Commission ("Commission") charged various defendants with violations of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934. The defendant Coven was charged with aiding and abetting various of these violations alleged to have been committed by one of the Underwriters, Carlton Cambridge & Co., Inc. ("Carlton") and its principal Joseph Rega, Jr., particularly with respect to certain violations of Rules 10(b)5, 6 and 9. A permanent injunction was issued against the defendant Coven, from which this appeal is taken.

On April 26, 1972, the Commission declared

effective a registration statement with respect to a public offering of Dennison Personnel, Inc. ("Dennison"). The underwriters of the issue were Carlton, of which Joseph Rega, Jr. ("Rega") was president, Stevens Jackson Seggos, Inc., of which Jules Ziffer ("Ziffer") was in charge of selling the issue. Defendant Coven acted as attorney for the Issuer and defendant Robert B. Levin acted as attorney for the Underwriters. The Issuer, co-underwriter Stevens Jackson Seggos, Inc. ("Stevens") and Ziffer were not made defendants in the action. The defendant Levin consented to the entry of a permanent injunction prior to the commencement of the trial. Other individuals who were named as defendants and against whom injunctions were issued were various employees of Carlton The Court, after trial, denied an injunction as against The Republic National Bank ("Republic") who acted as Escrow Agent of the issue.

Documents Relative to the Offering of Dennison and Escrow Provisions

The Dennison offering provided that the Underwriters would use their "best efforts" to sell a total of 6,000,000 shares of Dennison (offering price was $0.10 per share) during the maximum 90 business day period commencing

April 26, 1972 (Exh. 1 - 724a). The cover of the prospectus states, in reference to the proceeds of the issue, that "all monies will be deposited in escrow at the Republic National Bank . . . and returned promptly to subscribers in full without interest or deduction unless at least 3,000,000 shares are sold" (emphasis supplied). Again, under the heading "High Risk Factors" of the prospectus that "There is no provision for the return of funds to subscribers in the event that at least 3,000,000 but less than all of the shares offered hereby are sold." (726a).

Subdivision (b) of Section 3.01 of the Underwriting Agreement, filed as an Exhibit to the Dennison registration statement (Exh. 1) provides "Until said 3,000,000 shares of stock are sold the Underwriters shall deposit all funds received with . . . Republic. . . ." (emphasis supplied). (696a).

The Escrow Agreement (766a) provided that on the delivery date the escrow agent would deliver to the Company and to the Underwriters, respectively, the amounts of $255,000 and $45,000 (i.e. the amounts each of said parties would be entitled in the event that 3,000,000 shares were sold, the minimum) provided that such funds were sufficient to cover such payments shall be in the escrow account on

the delivery date. The Escrow Agreement further provided that the Underwriters were to deposit with the Escrow Agent not later than the third business day following the receipt, all funds received for the purchase of shares accompanied by appropriate letters of transmittal, listing the names and addresses of the purchasers of the stock and the number of shares purchased by each. With respect to the latter requirement of letters of transmittal accompanied by names and addresses of purchasers and the number of shares purchased by each, it developed on the trial that Republic National Bank ("Republic"), the Escrow Agent, did not receive letters of transmittal and the required information with each receipt of funds from the Underwriters. Republic ignored the requirement and did not inform the Issuer or its attorney that such information was not being received. It may be noted here that the Commission in the Dennisson issue required that the Underwriters file with the Commission each week, during the selling period, a list of the number of shares sold and the respective purchasers. (318, 319).

The Meeting of June 12, 1972 at Republic.

Commencing the effective date of April 26, 1972, the Underwriters forwarded to Republic receipts from the

sale of the issue. On advice from the Underwriters a closing was scheduled for May 30, adjourned to June 5 and then set at June 12. All of the principals were present at the Bank. Rega on behalf of Carlton brought to the closing an uncertified check in the sum of $31,503.75 stating that he had deducted therefrom the commissions due to Carlton, this being the last check for the fulfillment of the minimum requirements of the offering (40a - ¶58). In view of the fact that the check was uncertified, the closing could not be concluded. The check was sent for collection by Republic (793a) and the Transfer Agent of the Issuer was directed to deliver to Republic the stock certificates requisitioned by the respective Underwriters. In order to make its net check, the number of shares sold by Carlton had to be determined. (257a). It appeared that the number of shares sold was 3,075,000, 75,000 shares more than the minimum. (789a, 807a). As to be later determined from the original issue transfer sheets and from the shares of stock sent to Republic, the actual number of shares was 3,073,500. The difference of 1,500 shares represented $150 as the price of the shares was ten cents. The Issuer, after clearance of checks, received from Republic the sum of $259,814.25, $4,814.25 more than it would have received if the exact minimum of 3,000,000 shares had been sold (41a). From the amount due to

the Issuer, Republic deducted its fee of $750. On June 21, 1972, Bowes, president of the Issuer, drafted and sent a letter to the Transfer Agent that it had received payment in full for 3,073,500 shares of the original issue sale. This was done without consultation by Bowes with Coven, Dennison's attorney. (159a-160a, 522a-523a, Exh. 10 at 763a).

On June 12, 1972, Rega, on behalf of Carlton and at the request of the Bank, and at the Bank, executed a letter to the effect that Carlton had deducted its commissions from its last check and there was nothing further due to it. (40a, 237a-238a).

On June 13, 1972, Stevens advised Republic that 351,000 shares had been sold by it and its selling group and that Gotham Securities a member of its selling group had remitted net funds and stated commissions due it, $3,682.50. (40a - ¶60, 789a Exh. 19).

At the request of Republic, Coven submitted a letter to Republic on June 13 confirming the commission due to Stevens and directing that the balance of the escrow fund go to his client, Dennison (40a, Pre-Trial Order ¶59). The letter recited that 3,075,000 shares had been sold. As indicated above, it was subsequently determined by Republic that 3,073,500 shares had been requisi-

tioned by the Underwriters. (40a - ¶62, 41a - ¶64).

Carlton's payments to the Bank were made from its account at the Commercial Trust Company (N.J.). That account showed a balance of $75.000 minimum for the period June 12 to June 21, 1972, which represented $34,000 in excess of the commissions which it had deducted on its last check remittance to the Bank. (258a).

Republic determined for itself whether the provisions of the Escrow Agreement had been met. (40a - ¶64, 303a). In reaching its conclusion, the Bank totally ignored the requirements of the Escrow Agreement that it receive confirmations of sales, the names and addresses of purchasers by each of the Underwriters. It made no attempt to match confirmations and accepted the listings of the Transfer Agent and by counting the shares sent to it by the Transfer Agent. The record is barren of any testimony that the Bank informed either of the attorneys that it was receiving confirmations of sales and other required information with each deposit.

Minimum Number of Shares

The Court took the position that the minimum of the issue had not been met in view of the fact that the

escrow account did not reflect deposits of at least $300,000. It also stated in its Opinion that the figures of Carlton appeared to be "contrived". This was a surmise by the Trial Judge, totally unsupported by the evidence, and was based upon the fact that 1,145,000 shares ordered by Carlton from the Transfer Agent were in street name, and that these street name certificates in that number were posited upon the figure of 3,075,000 shares contained in Coven's letter to the Bank (Exh. 20 at 791a). At the trial, Marie Kolano testified that she was an employee of Carlton. She testified that she had counted all of the Dennison confirmations that had been received and that each of the confirmations that she had counted had upon them a "Paid" stamp, and that she had requisitioned the shares sold by Carlton from the Transfer Agent. (391a-396a, 403a). She specifically denied that Rega had added shares to be issued in street name after she had finished her street count. (404a). On cross by the attorney for Republic, Ms. Kolano testified as to names of persons who purchased shares that had been put in street name, including several customer witnesses who had testified for the plaintiff. (405a-409a).

At the trial the Commission's attorney stated

to the Court that he would not have expected Coven to have acted differently in the Dennison issue in the absence of the Manor* decision with reference to the escrow provisions. (662a). The Trial Judge indicated that the Manor case was distinguished in certain significant respects. (663a).

Carlton's Closing on its Books on New Issue Sales

Carlton unilaterally, and without consulting or notifying the Issuer or its attorney Coven, ceased taking indications or making sales of the new issue on May 29, 1972. (253a-254a). Rega told the Court that Carlton had indications of 3.5 million shares, but began to get cancellations. (234a). Rega then commenced trading the shares commencing June 2, 1972, or earlier, with his own customers. This conduct on the part of Carlton and Rega legally terminated new issue distribution, and on the first trade. The Court found that this in-house trading was of such a nature as to constitute a "distribution" within the meaning of Rule 10(b)6.

On June 15, 1972, three days after the closing

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* SEC v. Manor Nursing Centers, Inc., 340 F. Supp. 886, aff'd, 458 F.2d 1082 (2d Cir. 1972).

of June 12 related above, Carlton went into the National Quotation Bureau's "Pink Sheets", trading Dennison. (42a-¶68). This, also without notice to the Issuer or its attorney, Coven. It may be noted that the "Pink Sheets" are sold only to registered brokers (255a). Coven first learned that Carlton had gone into the sheets on June 29, 1972 on being told of it by Peter Caplin of Gotham Securities (343a) who was then in a dispute with respect to the cancellation of certain of his ordered shares. Coven told Caplin that in view of his trading the issue was over (344a).

M. S. Wien

M. S. Wien, a trader, appeared in the "Pink Sheets" on June 5, 1972. This was seven days before the closing in escrow of June 12 and more than seventeen days prior to any actual certificates of stock being available. In view of the fact that the closing had not taken place, and no stock was available, it was evident that M. S. Wien was in the sheets on a "when and if issued" basis. Wien obviously could not issue confirmations with a settlement date. The Trial Judge, who admittedly was not well-versed in securities law, held that M. S. Wien was trading in the "regular way", i.e., with five-day settlement and with ability to make delivery on the settlement date, which it

is submitted is patently absurd. The appearance of M. S. Wien in the sheets prior to closing was perfectly legal. Mr. Glusband, a S.E.C. investigator who testified for the plaintiff, stated that he was engaged in the surveillance of the issue, noted the appearance of Wien in the sheets and that such appearance represented no indicia of a violation(221a, 222a). Coven's attention was called to the presence of Wien in the sheets by Mr. Ziffer of Stevens Jackson Seggos, and Coven stated what was obvious, that Wien was in the sheets on a when-issued basis./ (422a) The Court below took the position that Coven, the attorney for the Issuer, had an obligation to call M. S. Wien, and look into the circumstances surrounding his market (C.C.H. Fed. Sec. Law Reporter ¶ 95,222 at pp. 98, 147).

Lian, a trader at Stevens, testified for the Commission that he was not surprised to find M. S. Wien trading because, he said, he knew it was going to appear. He said that he was making an assumption that Coven told him of this (316a-1). As the testimony developed, it was Ziffer who had told him, and that the witness was mistaken as to his knowledge that M. S. Wien would appear in the sheets. Ziffer testified that when he saw Wien in the sheets in the first week of June:

> "I asked the trader [Lian] if he knew anything about it and he said, "No" and I called Mr. Coven and asked him why the stock was being traded and he said, "It can be done on"---at the time I didn't know the exact terminology, but "on and if, as and when basis" (422a). (Matter in brackets added for identification.)

Again, on cross examination, Ziffer repeated that he saw the quotation of M. S. Wien, brought to the attention of Lian and at a face-to-face conversation with Lian, Lian "wanted to know how come" and that Lian did not indicate to Ziffer any previous knowledge that M. S. Wien would appear in the sheets (424a, 425a).

Coven testified that never at any time had he any contact of any sort with M. S. Wien (496a, 497a).

"Best Efforts"

The Court in its Opinion found that by reason of Carlton's unilateral cessation of the sale of the issue on May 29, Carlton violated Rule 10(b)-5 in the failing to use its "best efforts" to sell the maximum portion of the issue. The Court found that Coven aided and abetted the Underwriters' failure to use its "best efforts" in that Coven took no action to learn whether the Underwriters were attempting to sell the maximum portion of the issue. Except by the use of such adjectives

as " total disinterest", the closing down of the issue was unilateral as stated above, the closing in escrow was held on June 12, Carlton went into the "Pink Sheets" without notice on June 15, six days prior to the distribution of funds by the Escrow Agent bank and seven days prior to the distribution of certificates of stock by the Escrow Agent, there appears no proof that any lack of inquiry by Coven as to whether the Underwriters were continuing to sell the balance of the issue contributed to the failure of Carlton to use its best efforts" to sell the maximum portion of the issue. At the meeting at Republic bank on June 12, neither the underwriters nor their attorney informed anybody that the issue was closed down.

POINT I

COVEN DID NOT AID AND ABET CARLTON AND REGA IN THEIR VIOLATIONS OF RULES 10b-5, 10b-6 or 10b-9. FURTHER, THE COURT APPLIED ERRONEOUS CRITERIA FOR ITS DETERMINATION WITH RESPECT TO COVEN

"Best Efforts" and The Violation of Rule 10b-5

The Dennison issue was a minimum- maximum offer. The minimum to be sold was three million shares after which the balance of three million shares were to be offered on a "best efforts" basis by the underwriters. The offering contemplated two closings, the first when at least the minimum was met.

The first closing, after several adjournments and upon notice from the underwriters that at least the minimum had been met, was set for the 12th day of June, 1972.

On May 29, 1972, Carlton unilaterally and without notice to anyone stopped soliciting customers for the new issue and the following day started to trade with its own customers. This in-house trading could not be discovered by Coven, the attorney for the issuer except by the stationining of a permanent investigator at the premises and branches of Carlton,

which plainly he was not required to do. The Court found that Rega and Carlton by shutting down the sale of the new issue on May 29th violated their obligation to use "best efforts" and violated Rule 10b-5. It is evident that there was no conduct on the part of Coven which aided or abetted this violation and indeed there was no action that Coven could have taken to alter the circumstances that a violation had already occurred. It is also evident that when Carlton commenced trading, the issue was "closed" i.e. Carlton could not resume offering the new issue without violating Rule 10b-6.

On June 12, 1972 a closing was held in escrow in view of the presentation by Carlton of an uncertified check. On June 21st the escrow bank delivered to the issuer the proceeds due it for 3,073,500 shares (73,500 shares more than the minimum) and delivered stock certificates to brokers. On June 15, 1972 again without previous notice Carlton went into the Sheets of the National Quotation Bureau ("Pink Sheets") and quoted Dennison. These "pink Sheets" by rule are distributed to brokers only. This quote effectively terminated the issue offer, if it had not already been terminated by its inhouse trading

previously. Viewing these undisputed facts, it is submitted that it is absurd to find that Coven, the attorney for the issuer, aided and abetted Carlton and Rega in their failure to use "best efforts" in the sale of the maximum portion of the issue. As stated by the Court in its opinion upon a motion for reconsideration made by Coven:

> "The Court's finding that Coven aided and abetted this violation is keyed to Coven's total failure to make any inquiries with respect to the "maxi" portion of the offering." (110a)

Except for the bare conclusion that this "total failure" "contributed to the violations by Rega and Carlton to make "best efforts"" (110a) and the use of such phrases as "total disinterest" the Court does not spell out, as it could not, how such "failure" aided and abetted the claimed violation. This statement by the Court is made more incongruous by its holding that the minimum had not been sold. The fact is that the Court had no previous experience in securities matters. A great deal of time was spent in counsel explaining to the Court various securities terms, the mechanics of an underwriting and market activities.

It is plain that no inaction

on the part of Coven to learn whether Carlton was attempting to sell the maximum portion of the issue contributed to the violation of 10b-5 by Carlton and Rega in their failing to use "best efforts" to sell the second segment of the offering. At the closing of June 12th Rega did not in any manner indicate that the issue had been closed and that no further shares would be sold nor that Carlton was about to go into the quotation sheets, which it did three days later.

Violation of Rule 10b-6
and M.S. Wien

As stated above, a closing in escrow was held on June 12th. That it was determined that the closing be in escrow at the June 12th meeting. The actual closing date of June 21 when stock certificates were delivered and the issuer paid was not determined until a few days prior.

On June 5th, 1972 M.S. Wien, a trading house appeared in the National Quotation Bureau's "Pink Sheets" with a quotation on Dennison. At the time Wien appeared in the sheets no stock certificates were available and, as indicated, the closing had not taken place. The appearance of Wien in the sheets was perfectly legal procedure on the part of Wien.

Such trading was patently on a "when issued" basis. Glusband, a Commission investigator testified that such trading prior to the completion of the offering was perfectly legal and there was no indicia of a violation from such appearance (222a). Glusband was monitoring Dennison and noted the appearance of Wien, and saw no reason for inquiry.

Early in June Ziffer of Stevens Jackson Seggos Inc., a co-underwriter of the Dennison issue called the attention of Coven to the fact that M.S. Wien was in the pink sheets on Dennison. Although not the attorney for the co-underwriter Coven replied that the stock could be traded on a when, as and if issued basis. During the course of a conversation with Peter Caplin of Gotham Securities, a member of the selling group, at or about the same time Coven ventured the same opinion.

At the trial a trader at M.S. Wien testified that Rega had told him that the issue had been closed and free for trading, this on June 2nd. The Court held that Rega and Carlton had violated Rule 10b-6 by inducing Wien to go into the sheets at a time when Carlton was making a "distribution" i.e. selling stock to its own customers/in-house trading after it

had ceased offering new issue shares of Dennison.

The Court held [1/] that Coven had aided and abetted the 10b-6 violation of Rega and Carlton in that

> "He did not make the slightest effort to look into the circumstances surrounding M.S. Wien's market. Had he done so presumably he would have been informed that Rega had told M.S. Wien that the Dennison offering had ended and that it was proper to tradethe stock" (pp. 98, 147) [2/]

In the first instance, it is submitted that the attorney for the issuer is under no obligation to make an investigation "into the circumstances surrounding M.S. Wien's market". Secondly, the appearance of Wien in the sheets at a time when the closing had not been had and no certificates had been issued was perfectly within the rules. The Commission who noted the appearance saw no reason to make any inquiries.

Finally, the alleged inaction by Coven in not looking into the circumstances of the Wien market did not aid and abet Carlton and Rega in their violation of Rule 10b-6. Rega had unilaterally closed down the issue

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1/ The Court in its original opinion took the position that "distribution" as that term is defined by Rule 10b-6 continued until unsold shares of Dennison were dergistered (July 18, 1972). On motion for reconsideration the Court reconsidered its position saying that the Court "may have set a somewhat restrictive demarcation point" based solely upon when the stock was deregistered (111a) and held that Carlton was engaging in "distribution" by reason of its selling campaign to its customers in connection with its in-house trading activities.

2/ CCH Transfer Bender '75-'76, ¶95, 222.

and was trading with its own customers, a matter which the attorney for the issuer could have discovered only by the gift of clairvoyance. The 10b-6 violation occurred when Rega allegedly induced Wien to go into the sheets and no lack of inquiry by the issuer's attorney could be said to have facilitated that violation, assuming, arguendo, the obligation to make such inquiry.

Further, the Court indulges in unwarranted presumptions in what Coven would have discovered had he made the inquiry, "presumably he would have been informed that Rega had told M.S. Wien that the Dennison offering had ended and that it was proper to trade the stock". However, the trader at Wien was not privy to the fact that Carlton was then engaged in an intensive selling campaign to its own customers. Also, Rega at the trial denied ever having induced Wien to go into the sheets so that if presumptions are to be indulged in there is more certainty as to what an inquiry of Rega would have elicited.

It is submitted that in view of the above, the Court's statement (pp.98,147) that "Coven's indifferent attitude and his failure to exercise minimum due diligence in this regard facilitated Carlton and Rega's violation of Rule 10b-6" does not wash and will not stand up.

The Court also stated in its opinion (pp. 98, 140) that "when Coven was informed that M.S. Wien was in the sheets he blithely assumed that M.S. Wien was trading on a when issued basis". If the adjective can be suffered for the moment it may said that the Commission "blithely" made the same assumption, and at the same time. However, in view of the fact that no closing had been had and no certificates issued the trading of Wien cannot be characterized in any manner except as trading on a "when, as and if issued" basis.

The Court in its opinion stated inexplicably that Wien was trading "in the regular way" and maintained that position in its opinion on the motion for reconsideration. Caplin, president of Gotham Securities, testifuing for the Commission gave this definition of a "when, as and if issued" market (336a):

> "Well, the when, as and if issued market refers to a situtation in which a distribution of a new issue has not yet had a final closing and the stock is traded on an if basis, on a when, as and if basis, meaning trades made are only finalized after there has been a closing and the stock has been distributed. They can be rescinded if the issue never closes. "

CCH NASD MANUAL (Official Publication of the National Association of Securities Dealers, Inc.) at §4 ¶3504.10 defines a "regular way" contract as one

which calls for delivery of securities on the fifth business day following the date of the transaction" and continues:

> "A "when, as and if issued" or "when, as and distributed"contract differs from other contracts in that the securities called for have not been issued or distributed as yet, and the issue or distribution date may not have been determined. Consequently, a date for the settlement of such contracts must be determined after the date of issue or distribution of the securities becomes known."

It is evident that no confirmation issued by Wien could have had a settlement date in the absence of a closing and the availability of stock. It was logical and proper to assume that Wien was making a "when as and if issued" market. Indeed, there is no other definition available. The Court below characterized this conclusion as "not persuasive".

In addition to the finding that Coven assumed that Wien was trading on a"when as and if issued"basis the Court, swallowing a Commission suggestion, added that it appeared that Coven "had some knowledge beforehand" that Wien was to appear in the pink sheets to make a market on Dennison. This was taken from the ambiguous and suggested testimony of Liar, a trader at Stevens, Jackson, Seggos, Inc. He said he was not surprised to find M.S. Wien trading because he said he knew it was

going to appear. He assumed it was Coven that told him of this (TM 1047-316a-1) but it was also possible that Ziffer (in charge of Dennison sales) had told him this. (321a). The testimony of Ziffer was that he saw Wien in the sheets in the first week of June and further testified:

> "I asked the trader [Lian] if he knew anything about it and he said "No"..." (Name in brackets for identification) (422a)

On cross examination Ziffer repeated that he, Ziffer, saw the quotation of M.S. Wien, brought it to the attention of Lian and at a face to face conversation with Lian, Lian"wanted to know how come" and that Lian did not indicate to Ziffer any previous knowledge that Wien would appear in the sheets (TM 3150, 424a,425a). Both Lian and Ziffer were witnesses for the plaintiff.

There was no testimony from the trader at Wien that he had ever spoken to Coven; there was no testimony from Rega or anyone else that Coven had been informed that Wien would appear in the sheets; Coven denied the knowledge and further testified that he never had any contact whatsoever with Wien at any time. It is submitted that in any event all of this side matter is irrelevant as the Court's finding of aiding and abetting is based upon a supposed "blithe assumption" as to how Wien was trading and the failure to make inquiry.

It is submitted that Coven did not aid and abet the 10b-6 violation of Carlton and Rega and the use of such phrases as "indifferent attitude" and minimum due diligence" does not bridge the gap.

Rule 10b-9

The Issuer received full payment for 3,073,500 shares,which was 73,500 shares of stock over the minimum. The Court, however took the position that the minimum number of shares had not been sold because there was not $300,000 in the escrow account (Carlton having remitted a final net check, deducting its commissions) and that the number of shares given by Carlton as having been sold by it was contrived in that 1,000,145 of the shares ordered by it were in street name. The escrow agreement with the Republic bank provided that with each transmittal of funds the bank was to receive Letters of Transmittal listing the names and addresses of the purchasers of the stock and the number of shares purchased by each.

As noted above the closing of Dennison on June 12th was held in escrow by reason of the fact that Carlton had submitted an uncertified check for its final payment. The escrow closing arrangement provided that the Transfer Agent was to deliver all certificates to the

bank for counting against orders of brokers for shares.

On June 13th, one day after the closing, Coven at the request of the bank delivered a letter to the b ank indicating that 3,075,000 shares had been sold and stating the required distribution. Subsequently Coven learned from the bank that 3,073,500 shares had been sold in light of the fact that the Transfer Agent had remitted that number of shares. It is evident from the correction received from the bank that the bank did not rely on Coven's letter as to the number of shares sold. The bank also received assurances from both Carlton and Stevens Jackson Seggos as to the number of shares sold. The Court in finding no violation by the bank of Rule 10b-9 stated that it had no reason to suspect that "some of these assurances were less than candid" and that the bank had no reason to suspect "that the figures submitted to the transfer agent by Rega were in part contrived". In view of the fact that Coven had obtained his figures from the underwriters it would likewise appear that he would have no reason to suspect that less than the minimum had been sold or that any figures of Carlton were "contrived". Indeed, the bank had more information available, to wit, transmittal letters and the names and addresses of all purchasers.

In connection with its discussion with respect to the Republic Bank, the Court states that it had been informed that underwriters "were allowed to remit subscribers' funds net" (p.98,148). The Court picked this up from the Commission's brief which had misquoted the record (277a, 299a). The testimony of the bank official at the trial was that he had received a telephone call that 3,000,000 shares had been sold "and since they were sold the underwriters would be forwarding the proceeds to us " (emphasis added).

The determination of whether the underwriters could remit net on the last check when shares in excess of the minimum were sold was a question which concerned itself with the interpretation of the underwriting and escrow agreement and the statements contained in the prospectus. As the Court indicated on the trial the Commission had the opportunity during its review of the filing to clarify the seeming ambiguities. The attorney for the Commission conceded that the matter could have been clarified (411a).

The Court, adopting a Commission suggestion, first appearing subsequent to trial, stated in its opinion that Rega posited the number of street name certificates to meet the number of shares Coven repre-

sen ted to the bank in his letter to the bank of June 13 as having been sold. There was no evidence at the trial to support that conjecture, and indeed there is substantial and credible evidence to the contrary. (403a-409a) First, Rega's net check given to the bank at the closing being the final check determined the number of shares sold by Carlton; secondly, Coven's letter was addressed to the bank only; third,Rega testified that he was aware of what the co-underwriter had sold and had spoken to Ziffer (TM 544,548). Coven could get his information as to the number of shares sold only from the underwriters or their counsel.

On the trial the attorney for the Commission stated that he would not have expected Coven to act differently with respect to the escrow account in the absence of the Manor decision (S.E.C. v Manor Nursing Centers, Inc. 340 F. Supp 886, aff'd 458 F 2d 1082 (2nd Cir. 1972)) (662a). The trial Judge replied that the Manor case was distinguishable in certain significant respects (663a), as indeed it was. In the Manor case the escrow account was never opened, the parties to the closing exchanged worthless checks stock was issued for services under a fraudulent arrangement and in brief there was a multitude of violations in the nture of "blatant fraud".

The Standard Applied by the Court

The Court below employed a negligence standard in determining the liability of Coven as an aider and abettor, citing Securities and Exchange Commission v Spectrum, Ltd.489 F. 2d 535 (2d Cir 1973) It is submitted that under this standard Coven should not be held liable as an aider and abettor in that Coven could not have been able to conclude that his conduct was likely to be used in furtherance of illegal activity. Further, there is absent here the high degree of carelessness that was present in Spectrum Securities and Exchange Commission v Management Dynamics, Inc,515 F. 2d 801 (2nd Cir. 1975). Further, in Spectrum the attorney was "in control" of his letter writing. In the instant case Coven is not in a controlling position with reference to the underwriters or their market activities. The extension of responsibility envisioned by the claimed violations of Coven, attorney for the issuer, with respect to 10b-5 and 10b-6 in this case is, it is submitted, unwarranted. The attorney for the issuer had no means to monitor sales activities of underwriters nor to monitor the market making of underwriters in this case. Also in

contrast were the defendants in S.E.C. v National Bankers Life Ins Co., 324 F. Supp. 189, 195 (N.D. Texas 1971), all of whom were control persons directly involved and actively engaged in the operations of their respective firms.

Scienter Required

It is submitted that the landmark case of Ernst & Ernst v Hochfelder, 425 U.S. 185, 96 S.Ct. 1375, 47 L. Ed. 2d 668 (1976) ("Hochfelder") is applicable here. It is submitted that a finding of aiding and abetting a violation of Rules 10b-5,10b-6 and 10-9, all creatures of Rule 10(b) cannot lie in the absence of an allegation of scienter and the proof thereof i.e intent to deceive, manipulate or defraud. Both 10b-6 and 10b-9 are similarly worded to the terms of 10b-5 i.e. that the violation "shall constitute a 'manipulative or deceptive device or contrivance, as used in Section 10(b) of the Act..." which Hochfelder found as intended to proscribe knowing or intentional misconduct. The Hochfelder case is applicable to S.E.C. injunction actions Securities and Exchange Commission v Bausch & Lomb, 420 F. Supp. 1226 (1976 S.D.N.Y.). In a well reasoned opinion in Bausch & Lomb Judge Ward the Court held that the reasoning used by the Supreme Court compels that result (p.1240)

The Court noted that Hochfelder found " the language and history of §10(b) dispositive,(425 U.S. at 214 n.33, 96 S.Ct. at 1391), the Court continued: (p.1241)

> "If the 'language and history of §10(b) [are] dispositive' as to the scienter question in private actions, must they not also be so in "SEC suits for injunctions[which] are'creatures of statute.'" (citing S.E.C. v Management Dynamics) Argument drawing upon the words of §10(b) and the history, legislative and administrative, of §10(b) and Rule 10b-5 applies equally to private suits and actions brought by the Commission. Only policy considerations--which have traditionally been applied to distin guish the two kinds of cases- TGS, at 868 (Friendly, C.J. concurring) could support a contrary argument yet the Court noted:
>
> > " As we find the language and history of §10(b) dispositive of the appropriate standard of liability, there is no occasion to examine the additional considerations of 'policy' set forth by the parties, ... 425 U.S. 214, n. 33, 96 S.Ct. at 1391."

A further analysis of Hochfelder is set out by Judge Ward at p. 1242 n.4.

It is further submitted, that if the Court is to apply a standard of "recklessness" as to which Hochfelder left open as not then being required for its determination it must be of the kind of recklessness that is equivalent to a willful fraud.

It is submitted that Coven's conduct in this case would not support a finding of intent to defraud or such willful or reckless disregard equivalent to

intent to defraud, manipulate or deceive.

The case of S.E.C. v Universal Major Industries Corp., 546 F. 2d 1044 (2nd Cir. 1976) is not a holding contrary to Hochfelder when viewed in the light of the fact that it concerned a Section 5 violation. As was set forth by the Commission in its brief in that case at p. 34 "violations of the registration provisions of Section 5 do not require an inquiry into the state of mind of the person charged. The Court in any event found that the defendant had acted with knowledge or reckless disregard for the truth(at p. 1047).

POINT II

UNDER ALL OF THE CIRCUMSTANCES IT WAS AN ABUSE OF DISCRETION AND NOT APPROPRIATE THAT AN INJUNCTION SHOULD HAVE ISSUED AGAINST THE DEFENDANT.

It is submitted that in view of Hochfelder and Bausch & Lomb it would appear the Court is required to find that a likely future violation would be willful. Indeed, this Court has held that the consideration of scienter is a relevant factor in determining whether an injunction should issue S.E.C. v Spectrum, Ltd, cited supra. This Court saying that scienter may be a highly relevant factor to a

determination of whether the defendant has the requisite propensity to commit further violations.

The Court below did not properly take into consideration the absence of intent on the part of Coven to violate the law and the absence of bad faith. S.E.C. v Texas Gulf Sulpher Co., 320 F. Supp. 77,88 401 F. 2d 833, 868 (2nd Cir. 1968). The Court below in its opinion stated that "in fairness that the Court should note that the defendant Coven has indicated that he has made certain strict revisions in the procedures employed when involved in a distribution of the Dennison type." (p. 117a). While so stating, the Court however, did not weigh this factor with other factors present of good faith and the absence of intent to violate the law, and deemed such avowal in and of itself insufficient to defeat the application for injunctive relief. In Manor Nursing, cited supra, the Court there in characterizing defendants' violations found them "wilfully blatant and often completely outrageous" and therefore found that an injunction to be the proper remedy. Here, by contrast, Coven is charged with failing to make an inquiry in areas beyond his control and extending the liability of attorneys for issuers into new fields. Further, the

acts complained are isolated acts arising from peculiarly unusual circumstances. S.E.C. v Texas Gulf Sulphur Co., cited supra at p.868. It also may be noted that the instant case is one of first impression in that there are no previously reported cases in which an injunction was sought on the ground that the underwriter had not used its "best efforts" in the sale of an underwriting. Further, the injunction here was issued three years after the event and it is now five years, in effect a sentence of perpetual jeopardy See: S.E.C. v Texas Gulf Sulphur Co, cited supra,at p.888. In addition Coven neither participated in the activities of Carlton or benefited by them.

It is also submitted that the Court should give further weight to the impact of an injunction on Coven's professional career as an attorney. See, Mathews, Liabilities of Lawyers Under the Federal Securities Laws, 30 Business Lawyer 105 (1975). The continued repetition by the Commission that an injunction is prophylactic only and is not punishment is belied by the realities of life. Corporations can go forward after legal attacks and, not infrequently, corporate executives can do the same. However, it is most severly difficult for the attorney to maintain his community standing, his self respect, and his

financial security after questions have been raised concerning his integrity and an injunction issued against him.

It is respectfully submitted that the issuance of an injunction against Coven was not appropriate and was an abuse of discretion.

Respectfully submitted,

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United States Court of Appeals

For the Second Circuit

Docket No. 75-6099

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

against

BERNARD JAY COVEN,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

STATE OF NEW YORK
CITY OF NEW YORK } ss.:
COUNTY OF NEW YORK

Clarence Granza, being duly sworn, deposes and says, that he is over 18 years of age. That on the 1st. day of December, 1977, he served 2 Copies of the attached Brief for defendant-Appellant on the attorney for the Plaintiff-Appellee herein by depositing the same, properly enclosed in a securely sealed post-paid wrapper, in a U. S. Post Office at 90 Church Street, New York City, directed to said attorney at Securities and Exchange Commission, office of general counsel, Glen L. May, Esq. Associate Counsel, 500 North Capital Street, Washington, D.C. 20549

this being the place where they maintain an offices for the regular transaction of business, and the last address mentioned in the papers last served by them

Clarence Granza

Sworn to before me this

1st day of December, 1977.

Monroe D Rosen

MONROE D. ROSEN

MONROE D. ROSEN
Notary Public, State of New York
No. 24-4616600
Qualified in Kings County
Commission Expires March 30, 1979